No. 10,932

IN THE

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

UNITED STATES OF AMERICA,

Appellant,

vs.

PAUL W. SAMPSELL, Trustee in Bankruptcy of the Estate of El Camino Refining Company, STATE OF CALIFORNIA and UNIVERSAL CONSOLIDATED OIL COMPANY,

Appellees.

Upon Appeal from the District Court of the United States for the Southern District of California,

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BRIEF FOR PAUL W. SAMPSELL, TRUSTEE IN BANKRUPTCY, APPELLEE.

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BRIEF FOR PAUL W. SAMPSELL, TRUSTEE IN BANKRUPTCY, APPELLEE.

I.

Preliminary Statement.

The attorney for the trustee in bankruptcy actively participated in the proceedings before the referee in bankruptcy and the District Judge. Since the appeal to the Circuit Court of Appeals really involves a controversy between the United State of America, the State of California, and the Universal Consolidated Oil Company, with the trustee as a sort of a stakeholder, he thought, at first, he should not put the estate to the expense of his counsel preparing a brief. But it appears that the briefs

already filed in the appeal do not fully discuss the points involved as was done before the lower courts, so the trustee feels that he can be of assistance to the Appellate Court and should protect, as far as he can. the decisions of the lower courts by filing a short brief of his own on appeal; and does so with the consent of this court first obtained. The facts have been properly stated in the briefs already filed; likewise as to the questions presented.

II.

Summary of Argument.

1. Bankruptcy law and practice are statutory while equity proceedings are case made. An inchoate statutory lien, under the bankruptcy law, arising prior to bankruptcy, can be perfected after bankruptcy and relate back to the date when it became a lien pursuant to the applicable State or Federal law.

2. In order to sustain the contentions of the Federal Government, it will be necessary for the Appellate Court to overrule its previous decision in the case of *In re Knox-Powell-Stockton Co.*

3. Section 70c of the Bankruptcy Act places the State tax lien and the mortgage debt lien ahead of the Federal tax lien.

III.

ARGUMENT.

(1) Inchoate Statutory Liens, in Bankruptcy, May Be Perfected After the Date of Bankruptcy and Become Valid as of the Date They Attach Under Applicable State and Federal Law.

Section 67b provides, in effect, that, where by State or Federal law, statutory liens for taxes arise, but are not perfected before bankruptcy, they may be perfected thereafter and be valid as against the estate. The tax liens asserted by the State of California here, although inchoate as to amount, became fixed and attached to the real property of the debtor on January 1, 1939, and January 1, 1940, both these dates being prior to the time that the Federal tax liens attached to such property. See California Bank and Corporation Franchise Tax Act, Act 8488, Deering California General Laws (1939 Supplement), Sections 25 and 29.

The California courts have held that, with respect to ordinary taxes, liens attach on the first Monday in March of each year, notwithstanding the taxes are not fixed or payable until the assessment has been thereafter made, it being said that the subsequent assessment does not create the lien, but is merely one of the steps for its enforcement. *County of San Diego v. County of Riverside* (1899), 125 Cal. 495, 58 Pac. 81; *City of Santa Monica v. Los Angeles County* (1911), 15 Cal. App. 710, 115 Pac. 945; see cases collected, 24 *Cal. Jur.*, Taxation, Sec. 208, pp. 218, 219.

(2) It Will Be Necessary for This Caurt to Overrule Its Previous Decision in the Case of Knox-Powell-Stockton Co. If it Sustains the Federal Government's Contentions in This Case.

In the case of *In re Knox-Powell-Stockton Co.*, C. C. A. 9, 100 F. (2d) 979, 38 Am. B. R. (N. S.) 766, reference is made to the cases of *Spokane County v. United States,* 279 U. S. 80, 49 S. Ct. 321, 73 L. Ed. 621, and *New York v. Maclay,* 288 U. S. 290, 53 S. Ct. 323, 77 L. Ed. 754, which cases are heavily relied upon by the Federal Government in its contentions here. This court stated: "All of these cases arose under Section 3466 of the Revised Statutes, 31 U. S. C. A., Section 191, which grants priority to the United States over all other creditors when the debtor is insolvent. The cited cases establish that under this section an inchoate lien will not defeat the priority established by said section. But this being a bankruptcy proceeding, the provisions with respect to priority under Section 3466 of the Revised Statutes do not apply here. *Guarantee Title & Trust Co. v. Title Guaranty & Surety Co.,* 224 U. S. 152, 160, 27 Am. B. R. 873, 32 S. Ct. 457, 56 L. Ed. 706; *Davis v. Pringle,* 268 U. S. 315, 5 Am. B. R. (N. S.) 969, 45 S. Ct. 549, 69 L. Ed. 974; *Claude D. Reese, Inc. v. United States,* C. C. A. 5 (1935), 27 Am. B. R. (N. S.) 334, 75 F. (2d) 9. And in construing Section 67d of the Bankruptcy Act our inquiry as to what constitutes a lien thereunder is not embarrassed by the auxiliary consideration as to whether the lien of a tax not presently enforceable is sufficient to avail against a statutory preference which is to be literally construed in favor of the United States. *Spokane County v. United States,* 279 U. S. 80, 92, 93, 49 S. Ct. 321, 73 L. Ed. 621, quoting *Price v. United States,* 269 U. S. 492, 499, 46 S. Ct. 180, 70 L. Ed. 373.

These views are supported by the new Section 67b which became a part of the Bankruptcy Act by virtue of the Chandler Amendatory Act of 1938.

It seems strange that the case of *United States v. Reese*, C. C. A. 7, 51 Am. B. R. (N. S.) 660, 135 F. (2d) 466, a bankruptcy case heavily relied upon by the Federal Government, makes no reference at all to the decision of our court here in the *Knox-Powell-Stockton Co.* case. In the *Reese* case the Seventh Circuit relies upon Section 3466 of the Revised Statutes which our court here in the *Knox-Powell-Stockton Co.* case flatly states does not apply to bankruptcy proceedings; and, also, relies heavily upon the case of *New York v. Maclay*, 288 U. S. 290, 77 L. Ed. 754, which is discussed by our court here in the *Knox-Powell-Stockton Co.* case. The decision in the case of *United States v. Texas*, 314 U. S. 480, 62 S. Ct. 350, 86 L. Ed. 356, was decided after the decision in the *Knox-Powell-Stockton Co.* case. The case of *In re Van Winkle, DC, Ky.*, 49 F. Supp. 711, 53 Am. B. R. (N. S.) 296, is illuminative upon this subject.

The California Franchise Tax Act does not require these liens to be perfected after they accrue. Like the real estate taxes and the Oil and Gas Supervisor's taxes considered by the Circuit Court of Appeals for this Circuit in *In re Knox-Powell-Stockton Co.*, it is immaterial when the reduced amount of the taxes was determined in our case here, for the liens for such taxes attached upon the date specified in the statutes. Under the laws of California the lien is an immediate liability created by statute, and the levy and assessment are but a step necessary for the enforcement of the already existing lien, *i. e.*, a lien declared by a positive statute is not dependent for its existence upon subsequent acts requisite to its enforce-

ment. (See *County of San Diego v. County of Riverside,* 125 Cal. 495, 500; *Couts v. Cornell,* 147 Cal. 560, 564; *City of Santa Monica v. Los Angeles County,* 15 Cal. App. 710, 712; *National Holding Company v. Title Insurance & Trust Company,* 45 Cal. App. (2d) 215, 224.) The Federal Government quotes from the case of *State of Michigan v. United States,* 63 S. Ct. 302. Said case is not in point for the additional reason that the local taxes there involved *accrued* subsequent to the Federal Estate Tax lien there under consideration.

There is nothing new or strange in the proposition that statutory liens need not be perfected. In the case of *Detroit Bank v. United States* (1943), 63 S. Ct. 297, 298 (a companion case to the *Michigan* case, *supra*) it is pointed out that under Section 315(a) of the Revenue Act of 1926, the lien of the Federal Estate Tax attached at the date of the decedent's death without the necessity for an assessment, demand for payment, recordation of said lien, or any other procedure in order to perfect it as against subsequent liens.

(3) Applicability of Section 70c of the Bankruptcy Act in Connection With These Federal Tax Liens.

The claims of these Federal tax liens were not recorded in the office of the County Recorder of Orange County, California, where the property is located, or filed with the clerk of the district court within whose jurisdiction the property is situated. The liens arose, under the Federal Statute, by the filing of the assessments with the Collector of Internal Revenue at Los Angeles, which is about as obscure and inaccessible a place as could be selected to give reasonable notice to the public.

How far does Section 70c of the Act affect these Federal tax liens, whether perfected before or afterwards? That section provides that the trustee, as to all property in the possession or under the control of the bankrupt at the date of bankruptcy or otherwise coming into the possession of the bankruptcy court, shall be deemed vested as of the date of bankruptcy with all the rights, remedies and powers of a creditor then holding a lien thereon by legal or equitable proceedings, whether or not such a creditor exists. This is the status of all the property in our estate here.

The Federal Statutes themselves, Sections 3670, 3671 and 3672 of the *U. S. Internal Revenue Code,* state that the liens created thereunder, and here asserted, are inferior to the rights of a previous judgment creditor. The language of Section 70c of the Bankruptcy Act would surely include a judgment creditor, as well as any other kind of creditor. If that is so, then we are inclined to believe to be correct the view taken by the late Horace H. Glenn, Referee in Bankruptcy at Minneapolis and St. Paul, of the U. S. District Court of Minnesota, in his recent decision in the unreported case of *The Stenson Company,* No. 15, 591 in Bankruptcy. His decision was not appealed from by the Federal Government. In his decision, the referee stated:

> "Section 70c of the Bankruptcy Act gives the trustee all the rights, remedies and powers of a creditor holding a lien by legal or equitable proceedings, as to all property in the possession of or under the control of the bankrupt at the date of bankruptcy or otherwise coming into the possession of the bankruptcy court; and as to all other property the rights, remedies and powers of a judgment creditor holding an execution returned unsatisfied. Under Section

3672, Title 26, U. S. C. A. the lien is not valid as against a mortgagee, pledgee, purchaser or judgment creditor unless it has been filed as provided by state law. Minnesota has such a law, and no notice was filed. If Section 70c had read 'a judgment creditor holding a lien' instead of 'a creditor holding a lien by legal or equitable proceedings,' there could be no question. Of course a creditor holding a lien by legal or equitable proceedings is commonly a judgment creditor, although he need not necessarily be such. How are we to construe the words 'judgment creditor' in the phrase 'mortgagee, pledgee, purchaser or judgment creditor' in Section 3672? 'Mortgagee,' 'pledgee,' and 'purchaser' clearly refer to three classes of persons who have acquired a lien or an ownership interest in the property, but they do not include one who may have acquired such an interest through a judgment. I think it is a sensible construction to interpret this reference to a judgment creditor to mean a judgment creditor who has acquired an interest in the property, that is, a judgment lien creditor. It is this class of persons which it is obviously intended to protect by this provision. Why protect a judgment creditor without a lien any more than a contract creditor without a lien? When the words 'judgment creditor' were used instead of merely the word 'creditor' in this clause, it would seem reasonable to suppose that what was intended was a creditor who had by judgment acquired an interest in the property. I think this construction is valid, and that the trustee by virtue of his office has, under Section 70c, superior rights to the claimant, because of the failure to file the lien, if the lien was valid in any event. Another argument supporting this view is that 70c was intended to be wholly comprehensive as to the rights of the trustee. As to property *not* in the possession of or under the control

of the bankruptcy court he is given the rights of a judgment creditor, and it surely was not intended that his rights in property in possession should be any less, but rather that they should be more comprehensive.

Has the claimed lien any force in any event, in the absence of some seizure, segregation or designation of specific property? Section 3466 of the Revised Statues, which is Section 191 of Title 31 U. S. C. A., reads as follows:

'Whenever any person indebted to the United States is insolvent, or whenever the estate of any deceased debtor, in the hands of the executors or administrators, is insufficient to pay all the debt due from the deceased, the debts due to the United States shall be first satisfied.'

This provision dates back to 1797 and has been frequently construed. It is well-settled that it creates no lien and that its provisions are qualified by the Bankruptcy Act and are subject thereto. The lien provisions of Section 3670, Title 26 U. S. C. A., appear to date back to 1866. The United States apparently set the example for such blanket, inchoate lien legislation. Of course it was common for property taxes to be made a lien on the property taxed, but to make excise taxes, income taxes, and the like a lien against everything owned by the taxpayer is another matter. Many states enacted similar laws, seeking to give their taxes a lien status, and conflict has frequently occurred between Section 3466 R. S. and these state laws. The last Supreme Court decision in these cases is *United States v. Texas*, 62 S. Ct. 350, 48 Am. B. R. (N. S.) 514, and it follows numerous earlier decisions to the effect that these state statutes providing for a general, inchoate lien cannot prevail against the priority afforded the United States by Section 3466, and this notwith-

standing some of these statutes create a more specific lien than does Section 3670 relied on here, notably the Texas statute involved in the case last cited. The basis of these decisions is that these statutory liens, unaccompanied by any seizure or segregation of property, are inchoate and unperfected, serving 'merely as a caveat of a more perfect lien to come.' This is the medicine which the United States Supreme Court administers to the States, and I think the United States must take its own medicine when its inchoate, unperfected lien is brought in question.

The United States has all the protection possible if it will only follow its own procedure. It can proceed to make specific and enforce its lien the very day that lien attaches under the statute; it can at any time distrain any property of the taxpayer; if there is a bankruptcy it has a priority over everything except administration expenses and priority wages; if there is a general assignment or other liquidation outside of bankruptcy its debt is to be first satisfied under Section 3466; and if the taxpayer dies it has a similar priority in the probate proceeding. With all this comprehensive protection, it would seem to be little enough to require that the government follow its own prescribed procedure when it seeks to rely on its lien claim. If it does so, the property is segregated and is not left ostensibly free of liens for innocent persons to deal with. In these days everybody owes the Federal Government, or soon will, and if the claim made here by the United States is valid it will soon have a lien on practically all of the privately owned property in the country. It would be intolerable if in every ordinary commercial transaction account would have to be taken of this lien right."

It would seem to follow in our case, therefore, that the Federal tax liens here asserted, since they were never re-

corded in Orange County, or filed in the office of the Clerk of our District Court at Los Angeles, are invalid as against the trustee in bankruptcy, and can only be treated as claims of a creditor entitled only to priority of payment under Section 64a(4) of the Act. The condition of our estate here is such that it will be consumed by lien claims and expenses of administration, and there will be nothing left for priority and general creditors.

While the trustee's primary duty is to the general creditors (*In re San Joaquin Valley Packing Co.*, C. C. A. 9, 295 F. 311, 4 Am. B. R. (N. S.) 37), the trustee is trustee for all creditors. (*In re Scott,* D. C., Mich., 53 F. (2d) 89, 19 Am. B. R. (N. S.) 85, and *In re Lewensohn,* C. C. A. 3, 121 F. 538, 9 Am. B. R. 368.) So, therefore, it would seem that his status would protect the State and the mortgagee here as against Federal tax liens.

IV.

Conclusion.

By reason of the foregoing and the contentions made by the State of California and the Universal Consolidated Oil Company in their respective briefs and by a careful consideration of the Federal Government's contentions in their brief, the trustee is of the opinion that the decisions of the courts below are correct and should be affirmed on appeal.

Dated this 23rd day of May, 1945.

Respectfully submitted,

Grainger and Hunt.
By Reuben G. Hunt,
Attorneys for Trustee in Bankruptcy.